

— August 3, 2004 —



Audit Oversight

Followup Review of the Military
Department Audit Agencies Peer
Review

(D-2004-6-008)

— Department of Defense —
Office of the Inspector General

Quality

Integrity

Accountability

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Acronyms

AAA	Army Audit Agency
AFAA	Air Force Audit Agency
CPE	Continuing Professional Education
DAMIS	Defense Audit Management Information System
GAO	Government Accountability Office
GAS	Government Auditing Standards
NAS	Naval Audit Service
PCIE	President's Council on Integrity and Efficiency



INSPECTOR GENERAL
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August 3, 2004

MEMORANDUM FOR AUDITOR GENERAL, DEPARTMENT OF THE ARMY
AUDITOR GENERAL, DEPARTMENT OF THE NAVY
AUDITOR GENERAL, DEPARTMENT OF THE AIR FORCE

SUBJECT: Report on Followup Review of the Military Department Audit Agencies Peer Review (Report No. D-2004-6-008)

Government Auditing Standards (GAS) issued in June 2003 by the Comptroller General of the United States require that organizations conducting Government audits and attestation engagements have an appropriate internal quality control system in place and undergo an external quality control review. Organizations conducting audits and attestation engagements should undergo an external quality control review at least once every 3 years by an organization not affiliated with the organization being reviewed. The external quality control review should determine whether the reviewed audit organization's internal quality control system was adequate and operating effectively to provide reasonable assurance that established policies, procedures, and applicable auditing standards were being followed.

Background. During FY 2002, the Military Department audit agencies consisting of the Army Audit Agency (AAA), Naval Audit Service (NAS), and the Air Force Audit Agency (AFAA) completed external quality control reviews of each other. We determined at that time that the external quality control review results could be relied on to support the Inspector General of the DoD responsibilities for oversight of the Military Department audit agencies. For each of the reviews, the three review teams reported that the quality control systems were designed in accordance with the quality standards established by the President's Council on Integrity and Efficiency (PCIE). Further, the review teams reported that each organization's internal quality control system was operating effectively to provide reasonable assurance that audit personnel were following established policies, procedures, and applicable reporting standards. In addition, in a separate letter of comments, each of the review teams made observations and suggested actions to the audit agencies to strengthen their systems of quality control on areas of concern that did not warrant inclusion in the opinion report.

In a November 21, 2002, memorandum concurring with the results of the peer review, we stated that because some of the areas identified as deficiencies were repeat issues from the FY 1999 peer review, we would conduct a followup review to determine the status of the identified issues and the actions taken to implement the suggested actions in the peer review.

Review Objective. The objective of the review was to determine the status of the actions taken to implement suggestions and recommendations identified in the FY 2002 peer reviews of the Military Department audit agencies.

Results. The three Military Department audit agencies had taken action to correct the observations made in the FY 2002 peer review. However, the Military Department audit agencies still need to monitor continuously their internal quality control systems and

seek ways to make improvements, especially for repeat observations made in the FY 1999 and FY 2002 peer reviews. The scope and methodology of the review are in Appendix A.

Army Audit Agency. The AFAA had five observations concerning the AAA internal quality control system from the FY 2002 peer review. Of the five observations, two were repeated from the FY 1999 peer review.

1. AAA needed to provide auditors with a single reference for determining planning phase requirements and needed to develop guidance on reporting on the reliability of computer-processed data.
2. AAA could improve its annual quality assurance program by including broader-scoped quality control review projects with established milestones for each. (Repeat observation from FY 1999 peer review)
3. Comments in quality assurance reports did not indicate specific planned corrective actions and did not provide estimated completion dates.
4. Audit teams did not always comply with AAA established quality control requirements. (Repeat observation from FY 1999 peer review)
5. AAA did not prepare or update certain documents required for financial statement audits from prior year audits.

Guidance Needed. AFAA determined that the AAA should develop guidance that would serve as a single reference for auditors determining planning phase requirements. Also, the AAA needed to develop guidance that implements the reporting standard on the reliability of computer-processed data. The AAA developed USAAA Regulation 36-02, “Planning the Audit” dated July 14, 2003. Regulation 36-02 prescribed guidance for planning an audit engagement within the AAA including the planning process from identifying future audit areas to an entrance conference. In addition, AAA developed guidance on the reliability of computer-processed data that was included in USAAA Regulation 36-3, “Audit Survey and Execution” dated October 17, 2003. Specifically, Appendix G of Regulation 36-3 provided guidance on how to meet GAS for performing assessments on the reliability of computer-processed data and documenting the assessment results in the working papers and audit reports.

Internal Quality Assurance Program. In relation to the AAA quality assurance program, AFAA recommended that AAA include broader-scoped quality control review projects in the annual quality assurance plan and establish milestones for each quality control review project. The AFAA also recommended monitoring the project progress against each milestone and to the extent possible assigning one quality assurance staff member per project as a means to increase productivity.

Since the FY 2002 peer review, AAA had issued 10 internal quality control review reports compared to 3 reports issued from 1999 through 2002. To add broader-scoped reviews to the quality assurance program, AAA had instituted two types of internal quality control reviews: functional area reviews that covered multiple program directors and post audit quality reviews that were comprehensive reviews of individual

engagements for all program directors. Four of the 10 reports were post audit quality reviews.

Although additional resources were not added to the program, AAA had developed a FY 2003 through 2005 quality assurance plan that listed the planned milestones for each quality assurance project and the proposed number of personnel assigned to the project. At least one staff member was assigned to each project in the plan. To track project milestones for quality assurance reviews, AAA used the Army Audit Agency System for Information Storage and Transmission (AAAsist). Specifically, AAAsist ensures that employees and supervisors are aware of assigned tasks and due dates related to those tasks.

Management Comments. AFAA stated that the AAA Operating Deputy Auditors General comments in the quality assurance reports did not indicate specific planned corrective actions and did not provide estimated completion dates. A review of the AAA quality assurance reviews issued since the FY 2002 AFAA peer review showed that management comments were specific to include corrective actions and timelines for completion. Since the FY 2002 AFAA peer review, the AAA also developed an Excel spreadsheet that showed each quality assurance review report, the recommendations, the responsible office for the recommendation, whether there was concurrence with the recommendation, and the implementation date.

Compliance with Quality Control Procedures. Audit teams did not always comply with the AAA established quality control requirements consisting of supervisory review of working papers, completing the internal quality control review checklists, and independently referencing the draft report. According to AAA personnel, the three operating Deputy Auditor Generals briefed the importance of supervisory reviews during team and other meetings. Also, AAA issued guidance to all supervisors and managers on May 6, 2002, clarifying the AAA policy on supervisory review of working papers. Additional guidance was issued by AAA on March 5, 2004, that added requirements for supervisors to follow during the independent report referencing process. This guidance emphasized policies and procedures contained in USAAA Regulation 36-85, “Independent Report Referencing” dated October 31, 1996, for independently referencing agency reports. AAA has also provided training to agency employees on quality control issues and has continuously reviewed this area during its quality assurance reviews.

Financial Statement Audit Documentation. The AAA did not prepare and update from prior years audits certain documents the Government Accountability Office (GAO)/PCIE Financial Audit Manual required for financial statement audits. According to AAA, this issue had been put on hold and no action taken because the AAA no longer does financial statement audits.

Naval Audit Service. During the FY 2002 peer review of the NAS, the AAA made two observations with associated recommendations to improve the NAS internal quality control system. Of the two observations, one was repeated from the FY 1999 peer review.

1. The continuing professional education (CPE) statistics in the NAS training system were not complete.

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2. Audit teams did not always comply with quality control requirements in the NAS Handbook specifically related to referencing and supervision.
(Repeat observation from FY 1999 peer review)

Continuing Professional Education. AAA determined that the CPE statistics in the NAS training system were not complete. To improve the completeness of the NAS CPE statistics, the NAS added a paragraph to their Management Handbook requiring auditors to compare training records with data maintained in the Defense Audit Management Information System (DAMIS) training module and notify training personnel of any differences in the database. At the time of our review, the NAS was conducting an internal quality control review to determine whether they were in compliance with continuing professional education requirements relative to the GAS general standard related to competence.

Compliance with Quality Control Procedures. AAA also determined that audit teams did not always comply with quality control requirements in the NAS Handbook to provide reasonable assurance that audits were conducted in accordance with internal policies, procedures, and audit standards. To increase compliance, the NAS updated its referencer's certification form to ensure that draft reports are fully cross-referenced before referencing begins and that the NAS Assistant Auditor Generals were apprised of unresolved issues. NAS also updated the referencer's guidesheet to focus on identified improvement areas and to require the use of more experienced senior auditors with good performance records. In addition, NAS decided that referencers would be given orientation training before they referenced reports.

At the August 2002 Senior Leadership Conference, the NAS Auditor General, Deputy Auditor General, and Assistant Auditor Generals decided to require a certification by the Project Manager and Audit Director at the 90/240 day Auditor General briefings to ensure that supervision was being documented in accordance with the NAS Handbook. The senior leadership of the NAS also decided to implement automated working papers starting October 1, 2002, that would make it easier for the NAS to document supervision. In addition, on October 18, 2002, the NAS Policy and Oversight office emphasized to all GS-14 and above supervisors, in an e-mail, the need to follow requirements in the NAS Handbook pertaining to quality control forms, maintaining complete audit programs, documenting supervision, cross-referencing to working paper evidence, and adhering to audit reporting formats. Finally, the NAS provided a lessons learned document in October 2002 to employees that listed the NAS Handbook requirements identified by the AAA peer review and its own quality control reviews that were not being followed.

Air Force Audit Agency. The NAS made three observations regarding the AFAA internal quality control system. One of the three observations was repeated from the FY 1999 peer review.

1. AFAA was not in full compliance with the GAS CPE requirements.
2. AFAA did not have documented policies and procedures for identifying when consulting services were needed to support the audit.

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3. AFAA was not adequately cross-referencing facts and figures in audit reports to supporting working papers. (Repeat observation from FY 1999 peer review)

Continuing Professional Education Requirements. NAS determined that the AFAA was not in full compliance with the GAS CPE requirements. Specifically, the NAS reported that AFAA personnel claimed and received CPE credit for training that did not meet CPE guidelines, not all the AFAA auditors reviewed met the 20 hour or 80 hour CPE requirements, and there was no AFAA organization-wide mechanism to track CPE hours.

To improve compliance with the GAS CPE requirements, the AFAA issued a November 4, 2002, memorandum to all employees that provided nine examples of programs, activities, subjects, and topics that did not qualify for CPE hours. The memorandum also encouraged the reading of the GAO “Interpretation of Continuing Education and Training Requirements.” The AFAA had also conducted an internal quality control review to determine whether the FY 2002 NAS peer review observations had been corrected. In a July 8, 2004, report, the AFAA stated that its review of training documentation for 30 of 752 assigned auditors disclosed all had met the 20 hour or 80 hour CPE requirements and that the auditors only received CPE credit for allowable training classes. In addition, as of January 6, 2003, the AFAA implemented/identified the DAMIS training module as the AFAA sole source for agency personnel to identify desired training; complete and submit the required forms for requested training; and track/certify CPE requirements.

Guidance for using Consultants. NAS also determined that the AFAA did not have documented policies and procedures for identifying when consulting services were needed to perform the required task. The AFAA added Chapter 20, “Use of Outside Consultants” to AFAA Instruction 65-103, “Audit Management and Administration” dated October 9, 2002. This chapter states that the audit teams will coordinate all decisions to use consultants with Headquarters AFAA and obtain Auditor General approval. In addition, the chapter requires that the audit teams identify the need for technical assistance as early as possible to allow sufficient lead-time to identify and acquire the required skills. Finally, the chapter provided certain requirements for audit teams to follow before they engage a consultant.

Cross Referencing of Reports. NAS determined that facts and figures in audit reports were not adequately cross-referenced to supporting working papers as required by AFAA policies and procedures. NAS attributed the inadequate cross-referencing to lack of attention by audit managers and lack of knowledge by the audit staff of GAS as implemented by the AFAA audit regulations.

To improve cross-referencing of audit reports, the AFAA issued a memorandum dated October 31, 2002, to all employees stating that the requirement to cross-reference was well documented by AFAA Instructions 65-101, “Installation-Level Audit Procedures” and 65-102, “Centrally Directed Audits,” and both should be reviewed.

In addition, AFAA reported in an internal quality control review report dated July 8, 2004, that audit personnel were adequately cross-referencing summary working papers to supporting documentation. AFAA evaluated the results of five internal quality control reviews completed in 2003 and 2004. The five internal quality control reviews

evaluated a total of 15 audit reports. Specifically, AFAA summarized the quality control checklist question from the five internal quality control reviews on whether the audit manager cross-referenced all facts, figures, and assertions in the draft report to the summary working papers and the summary working papers to the supporting working papers.

The results of summarizing the question from the five AFAA internal quality control reviews indicated that 13 of the 15 audit reports fully met the cross-referencing requirements stated in the quality control checklist while the other two reports partially meet the requirements.

If you have any questions, please contact either Robert L. Kienitz at (703) 604-8754 or George P. Hunter at (703) 604-8756.


Patricia A. Brannin
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Attachment

Appendix A. Scope and Methodology

Review Scope and Methodology. This review was performed from March through July 2004 in accordance with standards implemented by the Inspector General of the DoD. We reviewed the Military Department audit agencies FY 2002 peer review reports and letter of comments to determine what observations and recommendations were made for each of the audit agencies. We also obtained and reviewed policies and procedures, internal quality assurance reports, and other documentation related to the Military Department audit agencies implementation of the observations and recommendations made from the FY 2002 peer review. In addition, we discussed with the responsible agency personnel what action each of the Military Department audit agencies took regarding the observations and recommendations made.

Review Limitation. There was a limitation for the review in that we did not do any testing to determine whether the actions taken by the Military Department audit agencies were effective in improving the internal quality control system of each of the respective agencies.

FY 2002 Peer Review Reports. Copies of the Military Department audit agencies FY 2002 peer review reports and the Inspector General of the DoD overall assessment can be found at <http://www.dodig.osd.mil/Inspections/APO/externalreview.htm>.